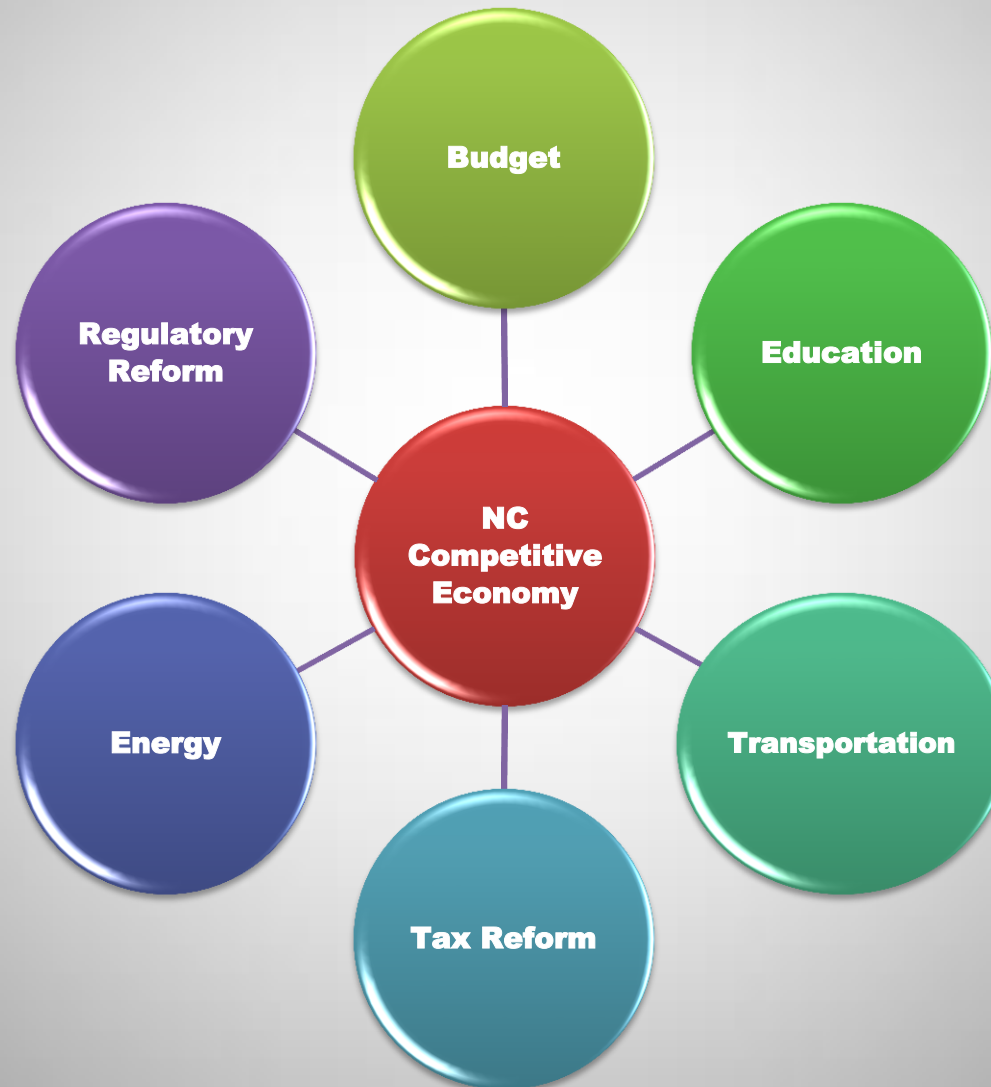


# The Economic Case for Continued Tax Reform In North Carolina



Michael Hannah  
Senate Finance Counsel

# The Strategic Plan For a BETTER North Carolina



# Surprising Statistics

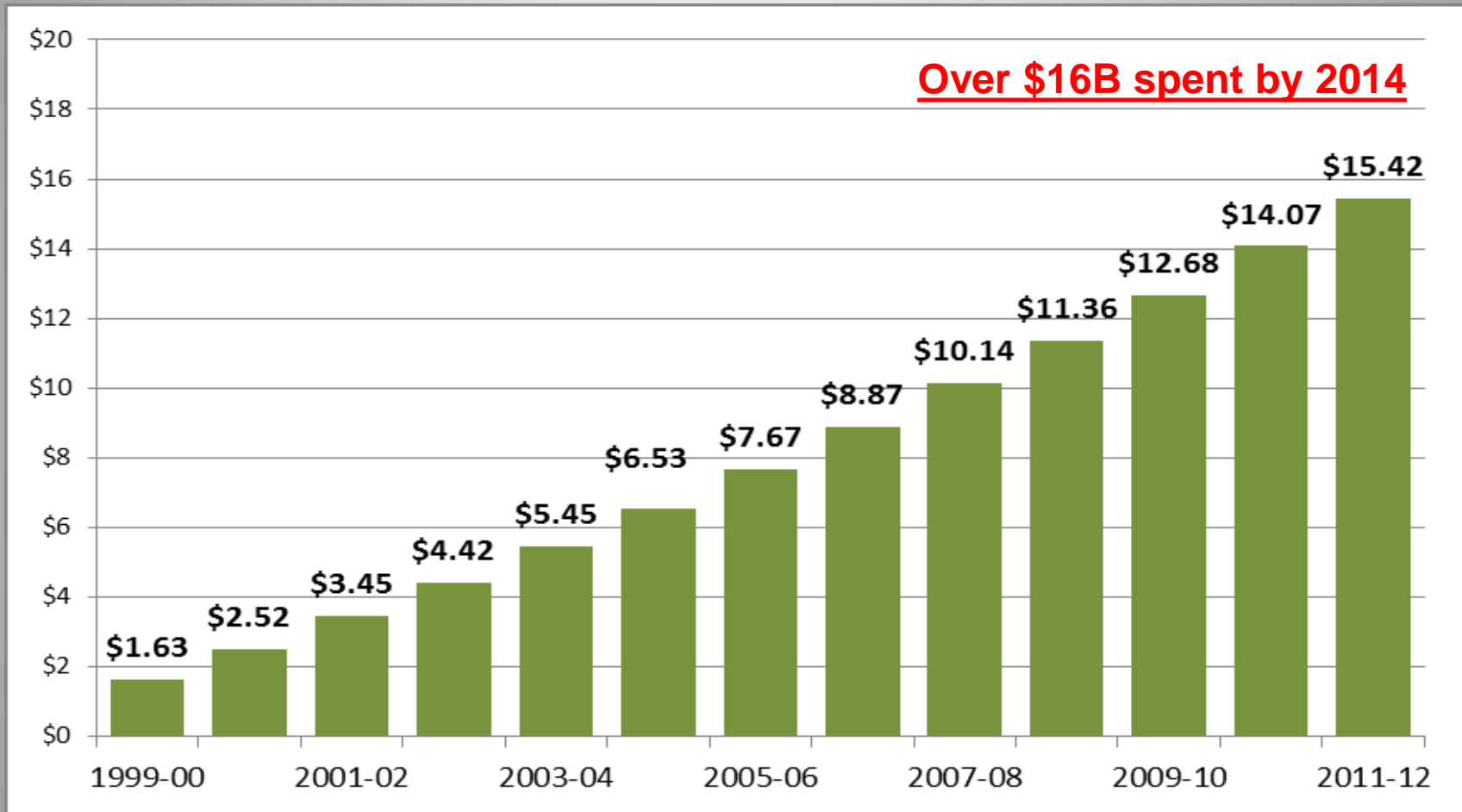
Despite being one of the “Best Business Climates” in the U.S. during the last 15 years according to *Site Selection Magazine*, *Forbes Magazine* & other publications....

in North Carolina:

- Job creation has not kept pace with workforce growth
- Wage and income growth & poverty is worse than the U.S. average
- From 1990 to 2000, we were **11<sup>th</sup>** in wage and income growth in the U.S.
- By 2013, we had fallen to **43<sup>rd</sup>**

# NC Econ Development Spending\*

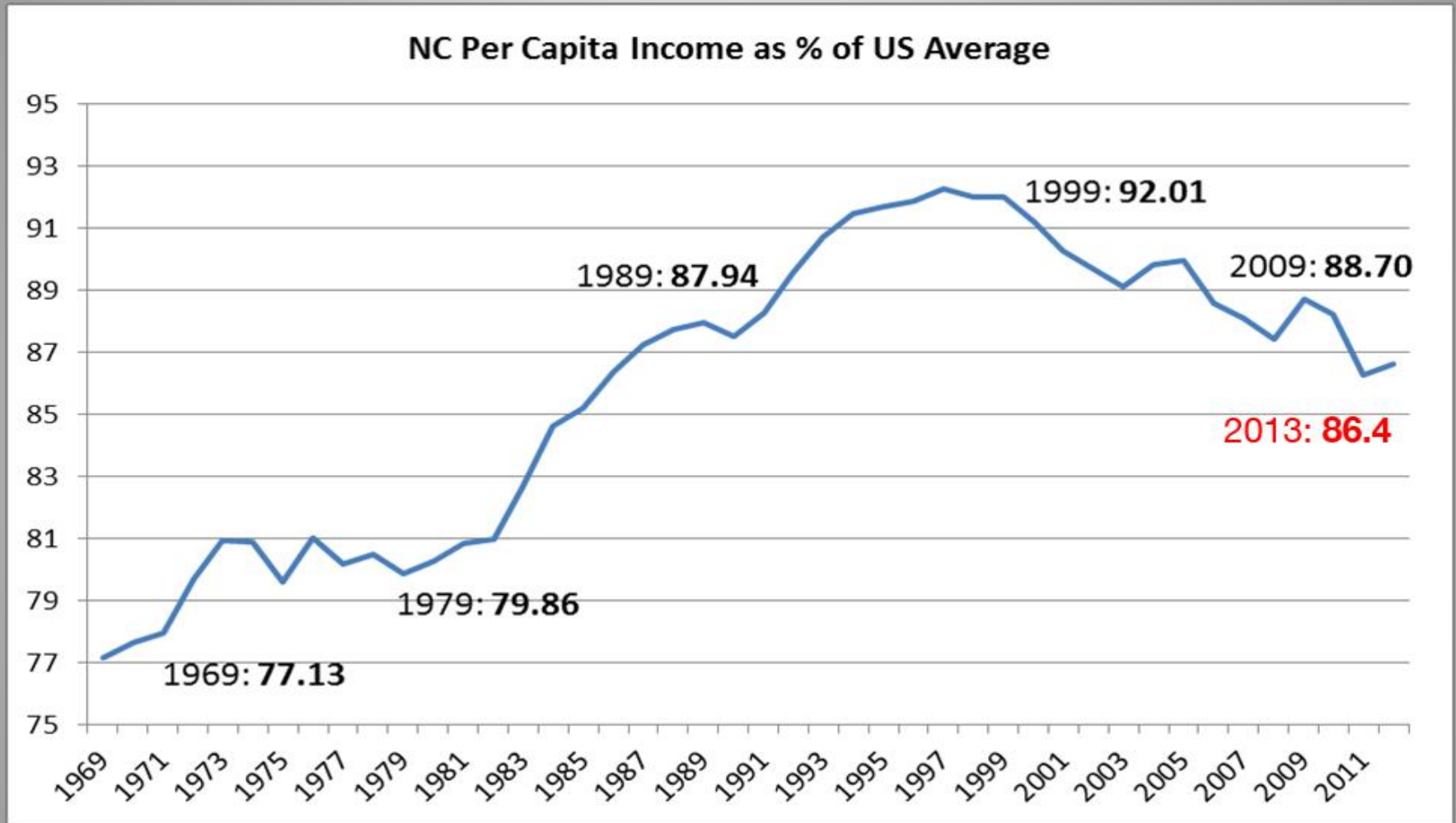
(cumulative, \$ billions)



\*Includes an estimate of all State tax expenditures with an economic development purpose.

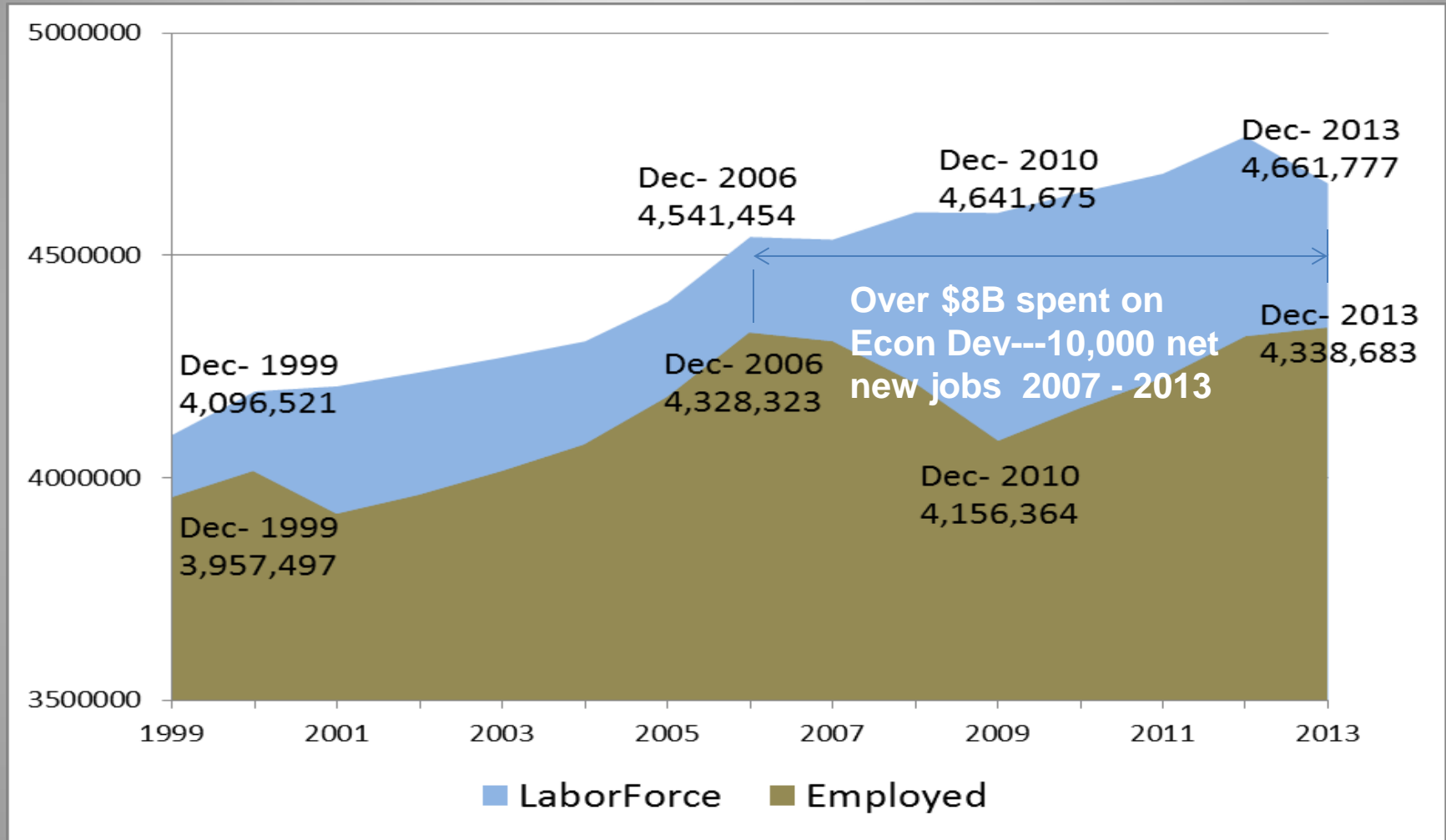
Source: NCGA Fiscal Research Division, Economic Development Inventory report

# Decline in NC Per Capita Income



Source: Compiled by NCGA Fiscal Research Division using data from the US Bureau of Economic Analysis

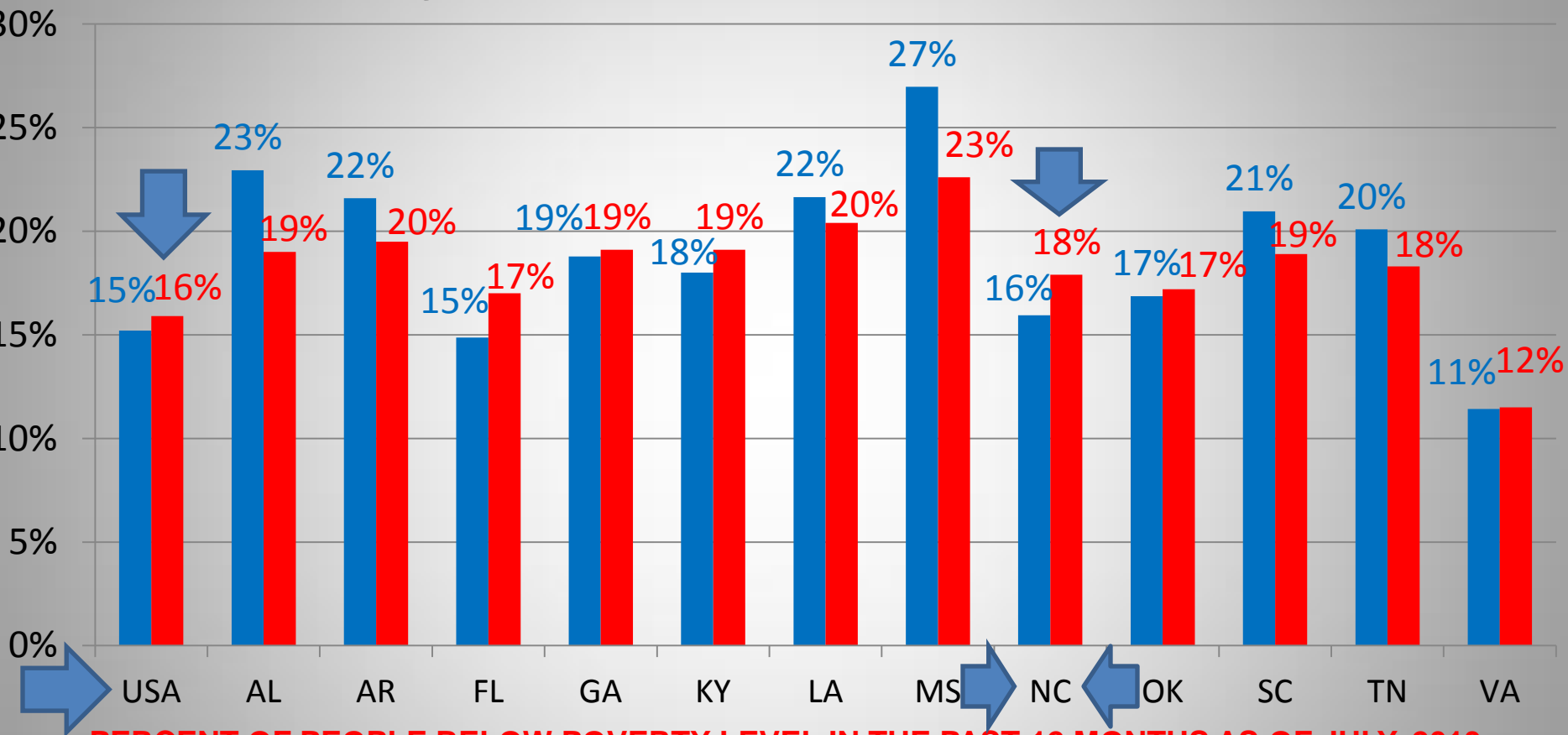
# Job Creation Performance in NC 1999 - 2013



Source: Compiled by NCGA Fiscal Research Division using data from the US Bureau of Labor Statistics

# Southern States

## Percentage of People Living Below the Poverty Rate in 1983 (Blue) & 2013 (Red)

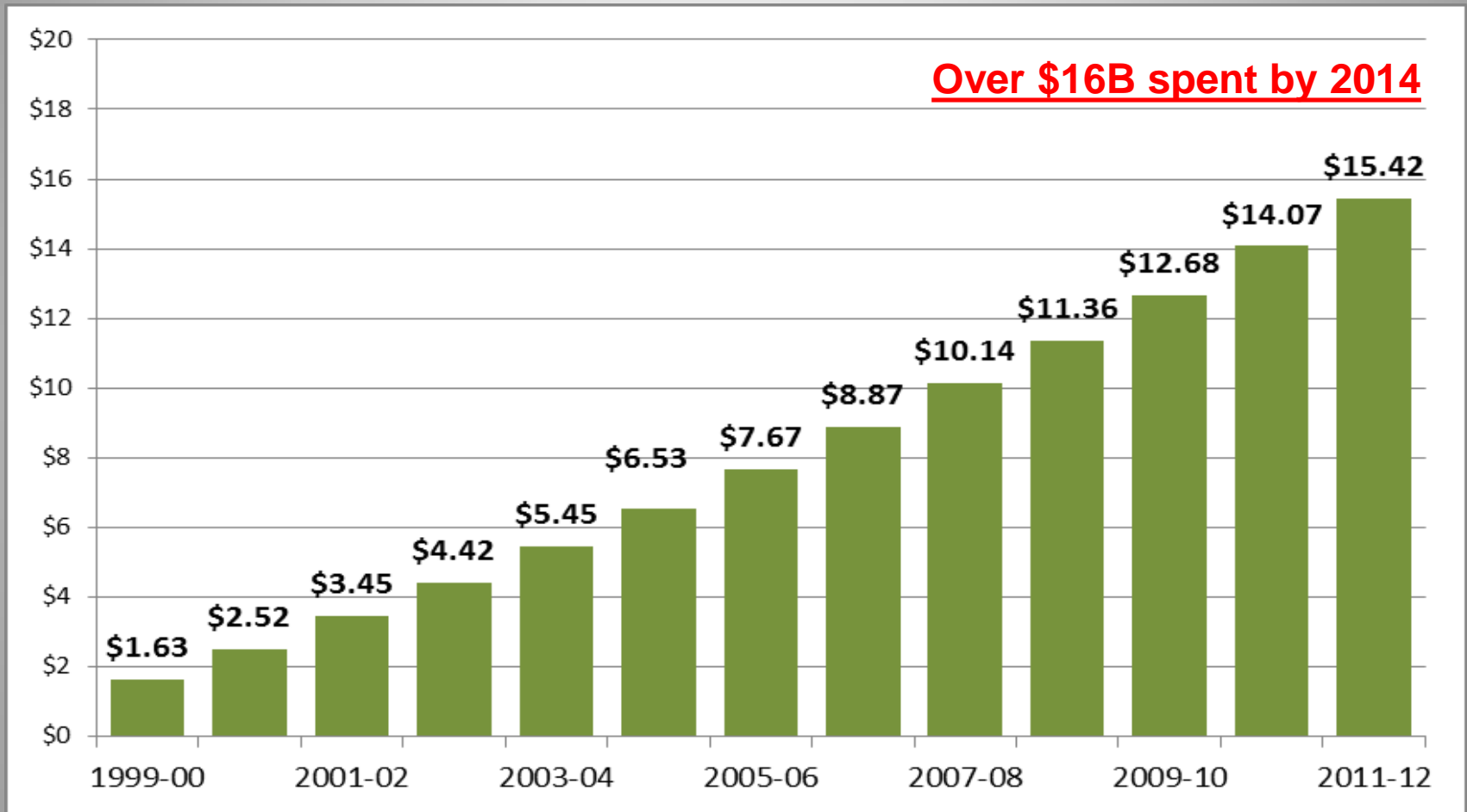


PERCENT OF PEOPLE BELOW POVERTY LEVEL IN THE PAST 12 MONTHS AS OF JULY, 2013

Source: US Census, American Fact Finder, July 2013,SGPB Profile of the South, 1986

# NC Econ Development Spending\*

(cumulative, \$ billions)



\*Includes an estimate of all State tax expenditures with an economic development purpose.

Source: NCGA Fiscal Research Division, Economic Development Inventory report



**2009 Final Report to the General Assembly  
On Economic Incentives  
from the UNC Center for Competitive Economies:**

- 1. Spending on tax credits vastly exceeds discretionary spending**
- 2. Tax credits are not tied to development goals**
- 3. Majority of tax credits claimed in non-distressed areas & do not benefit distressed counties**
- 4. Majority of tax credits claimed for investments in machinery & equipment, not job creation**
- 5. Discretionary incentives are more effective than tax credits at inducing job creation and for strategic development targeting**

# **SALES TAX ISSUES IMPACTING REVENUES**

A large, downward-pointing arrow. The left side of the arrow is blue with a yellow star and the letters 'N' and 'C'. The right side is white. In the center, there is a circular seal of the State of North Carolina, featuring two women, one holding a torch and the other a cornucopia, with the text 'THE SEAL OF THE STATE OF NORTH CAROLINA', 'MAY 20, 1775', and 'ESSE QUAM VIDERI'.

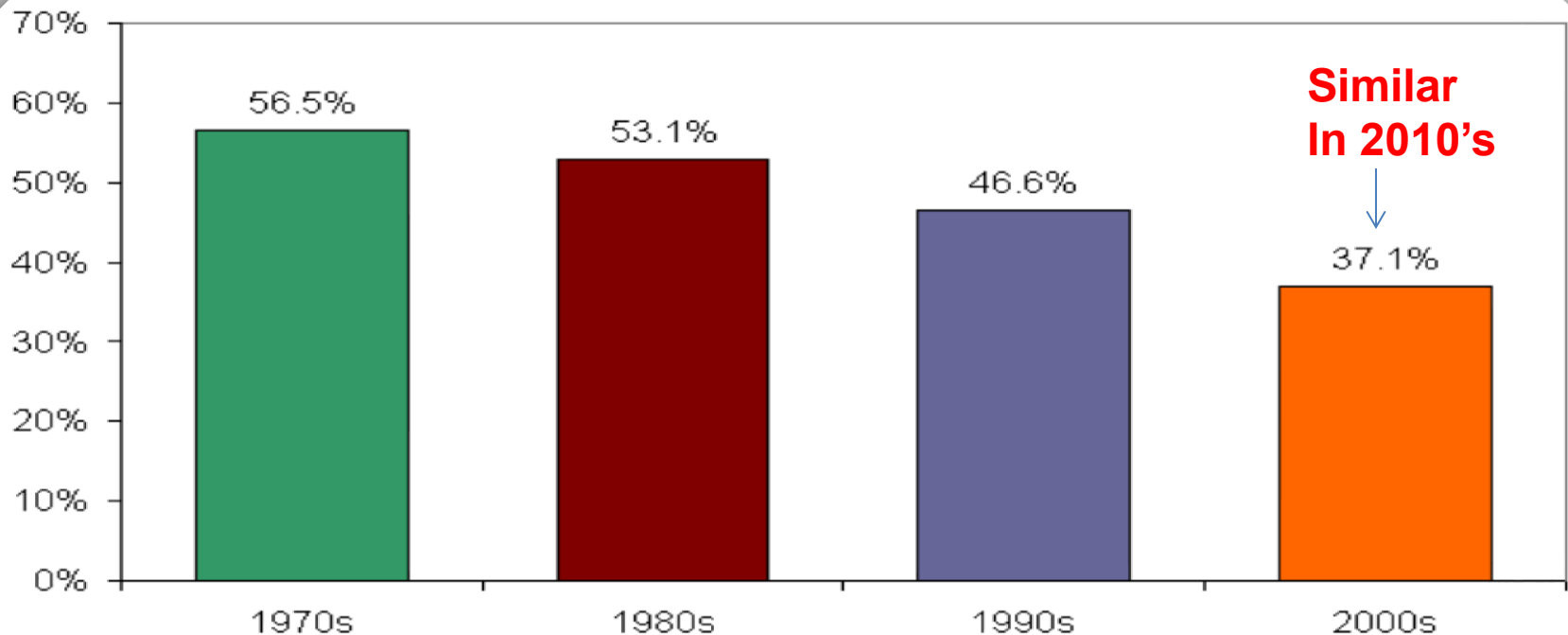
**Shrinking Sales  
Tax Base in North  
Carolina.....**

A large, upward-pointing arrow. The left side of the arrow is blue with a yellow star and the letters 'N' and 'C'. The right side is white. In the center, there is a circular seal of the State of North Carolina, featuring two women, one holding a torch and the other a cornucopia, with the text 'THE SEAL OF THE STATE OF NORTH CAROLINA', 'MAY 20, 1775', and 'ESSE QUAM VIDERI'.

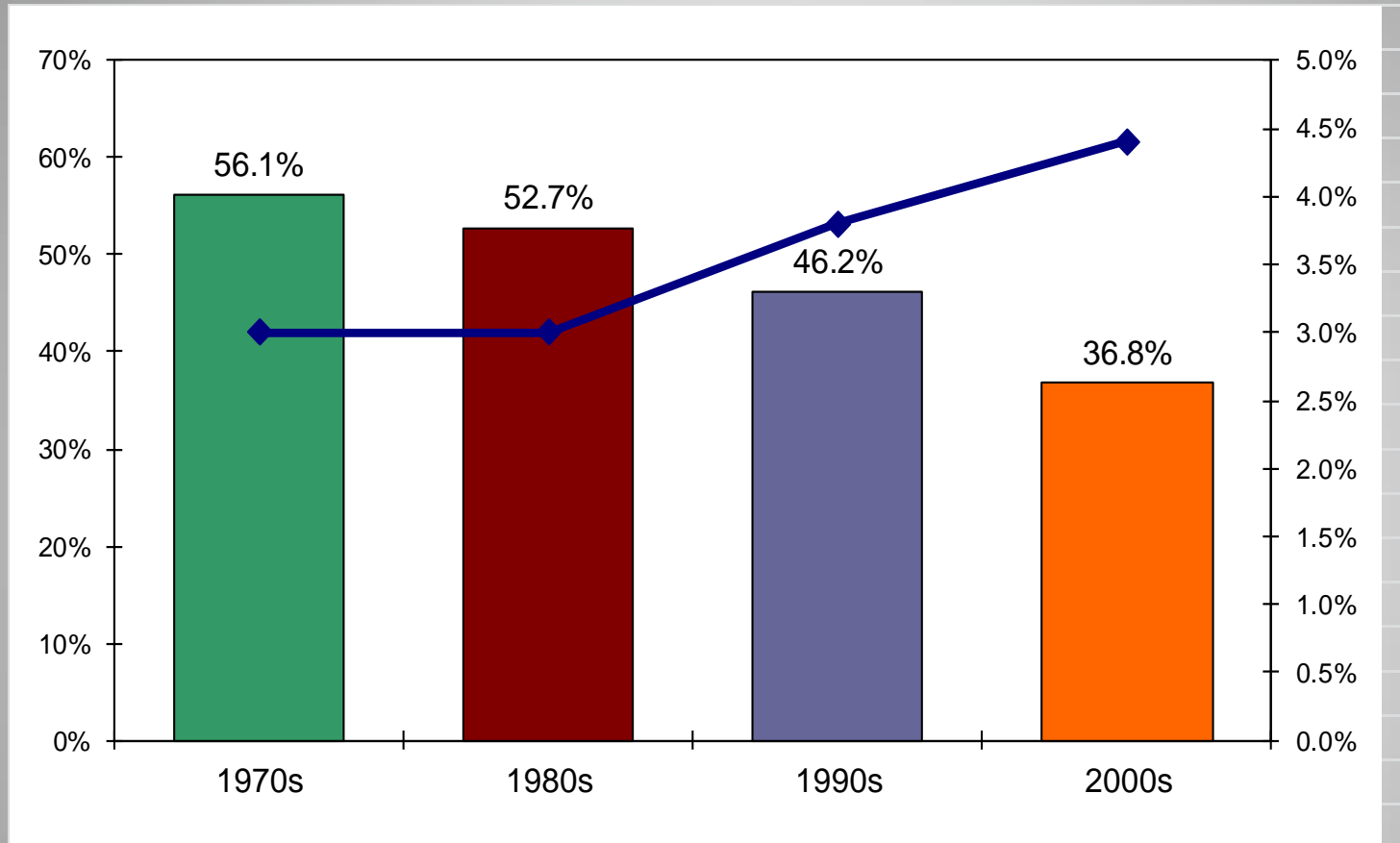
**Increasing Sales  
Tax Rates**

# The Shrinking Sales Tax Base

- The sales tax base in NC has narrowed significantly over time.....
  - The graphs indicate how North Carolinians spend \$100 of their income as a % of items subject to sales tax
  - We spend a smaller % of our income on items subject to sales tax now than in the 1970's ....
  - And more on services not subject to sales tax



# Shrinking Base = Rising Tax Rates



But in order to keep up with a declining tax base, State sales tax rates were increased starting in 1991 from 3% to a high of 5.75% in order to maintain revenue collections. **State rate reduced to 4.75%**

# Why Has Sales Tax Base Shrunk?

- **Legislative Decisions**

- **Enactment of Special Tax Preferences**

- Exemptions for some entities
    - Refunds for some entities
    - Lower tax rates for some entities

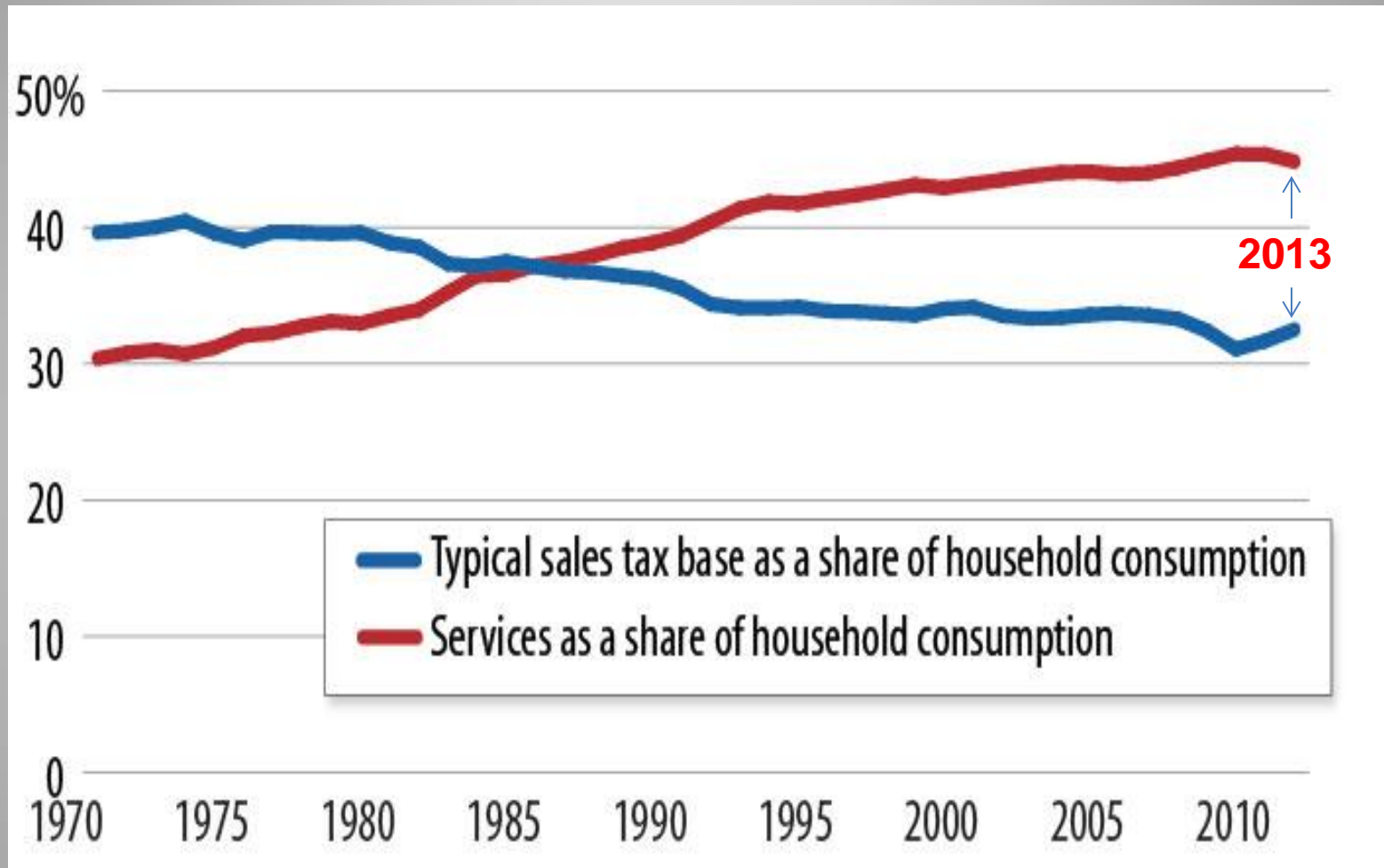
- **Exemption of food from the base**

- **Changes in Consumer Buying Patterns**

**More spending by consumers on non-taxable services and less on taxable items**

**Sales of services now constitute nearly 2/3's of the economy for consumers**

# Erosion of the Sales Tax Base in U.S.



Source: Michael Mazerov, Sr. Fellow, Center on Budget & Policy Priorities

## A Nationally Recognized Sales Tax Expert Says:

- Sales tax is a tax on consumer spending
- American sales tax is and historically has been essentially a tax on the sale of tangible personal property at retail
- But the absence of sales tax on services is more the product of historical accident than logic—many fewer services existed when most sales taxes were enacted

From: *“Sales Taxation of Services: An Overview of Critical Issues”* by Walter Hellerstein

## **A Nationally Recognized Sales Tax Expert Says:**

- **Purchase of retail services IS consumer spending**
- **There is no difference between tangible personal property and services that would warrant a different tax treatment**

**From: “*Sales Taxation of Services: An Overview of Critical Issues*” by Walter Hellerstein**



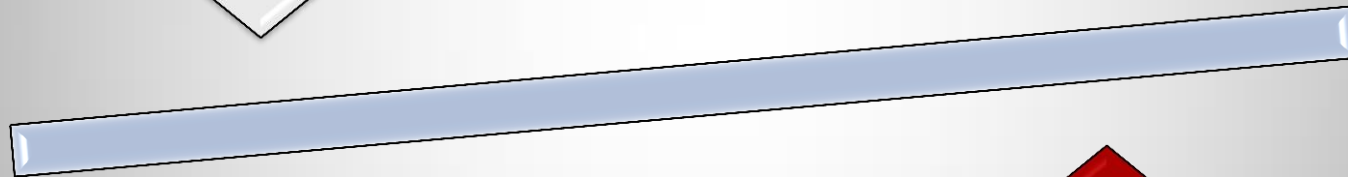
# Many Calls to Expand NC Sales Tax Base

- 1951 – Revenue Commissioner Eugene Shaw – eliminate all exemptions except those on business inputs and expanding the base to include services
- 1991 – Economic Future Study Commission – expand base to more retail services, eliminate exemptions except those for business inputs
- 2002 – Governor’s Commission to Modernize State Finances – expand base to more retail services
- 2005 – N.C. Budget & Tax Center Study – expand base to more retail services
- 2006 – State & Local Fiscal Modernization – expand base to more retail services      **See a Trend here?**

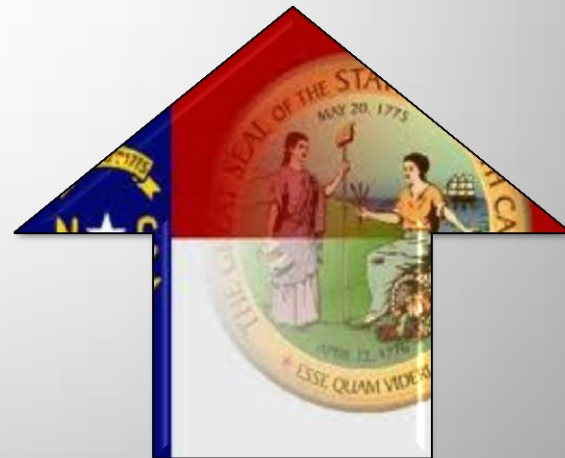
# INCOME TAX ISSUES IMPACTING REVENUES



**Unstable  
Income Tax  
Base**



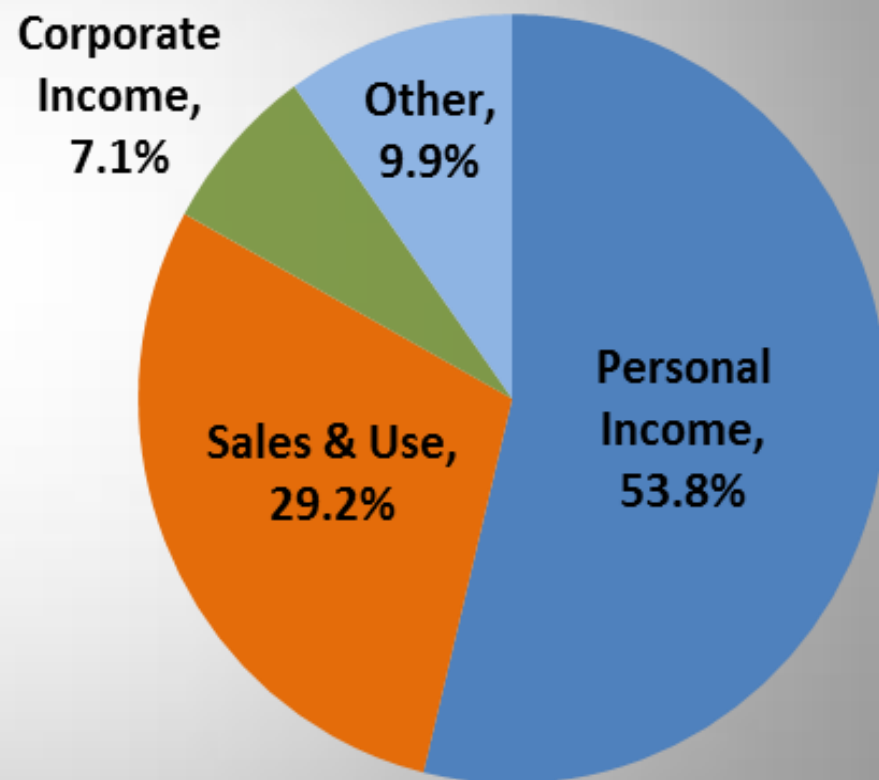
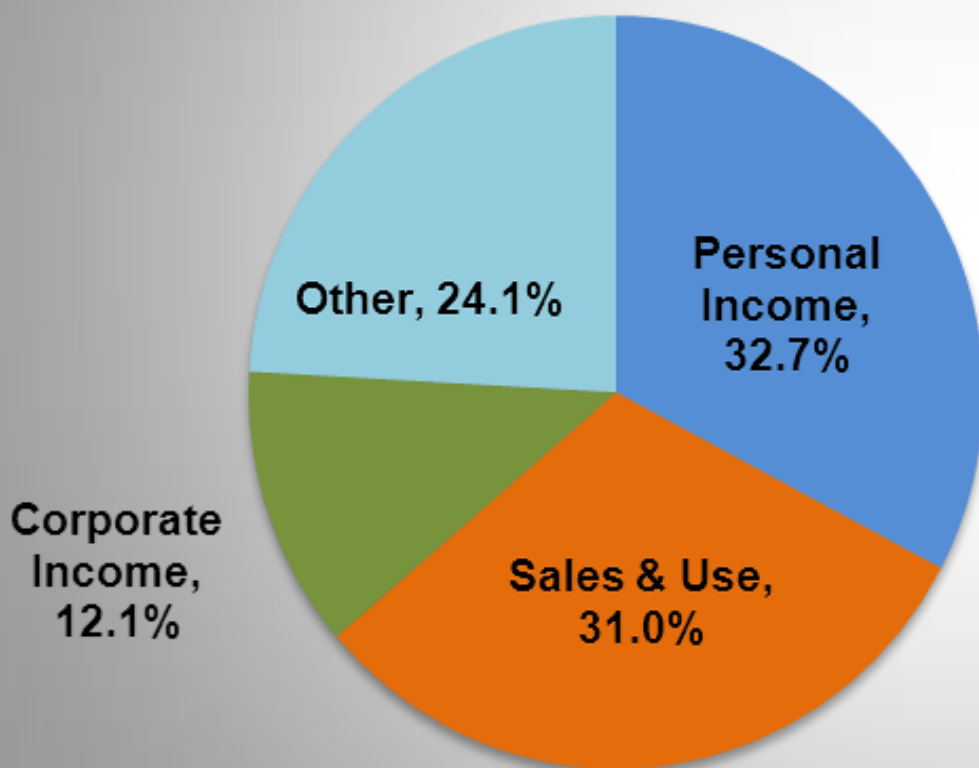
**Increasing  
Tax Rates in  
North  
Carolina**



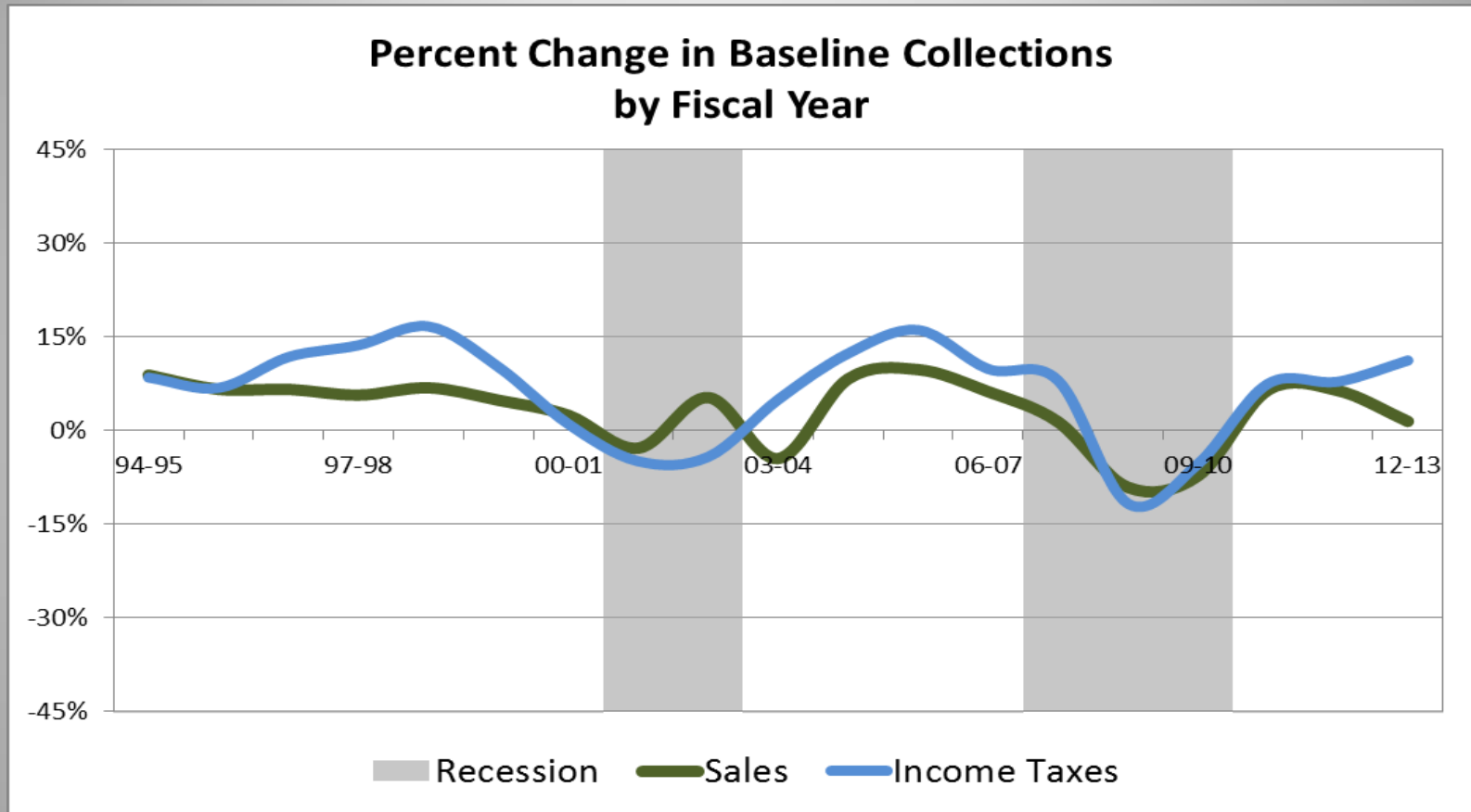
# Increasing Reliance On Income Taxes for State Revenues

**1970 - 49.8%**

**2014 – 60.9%**

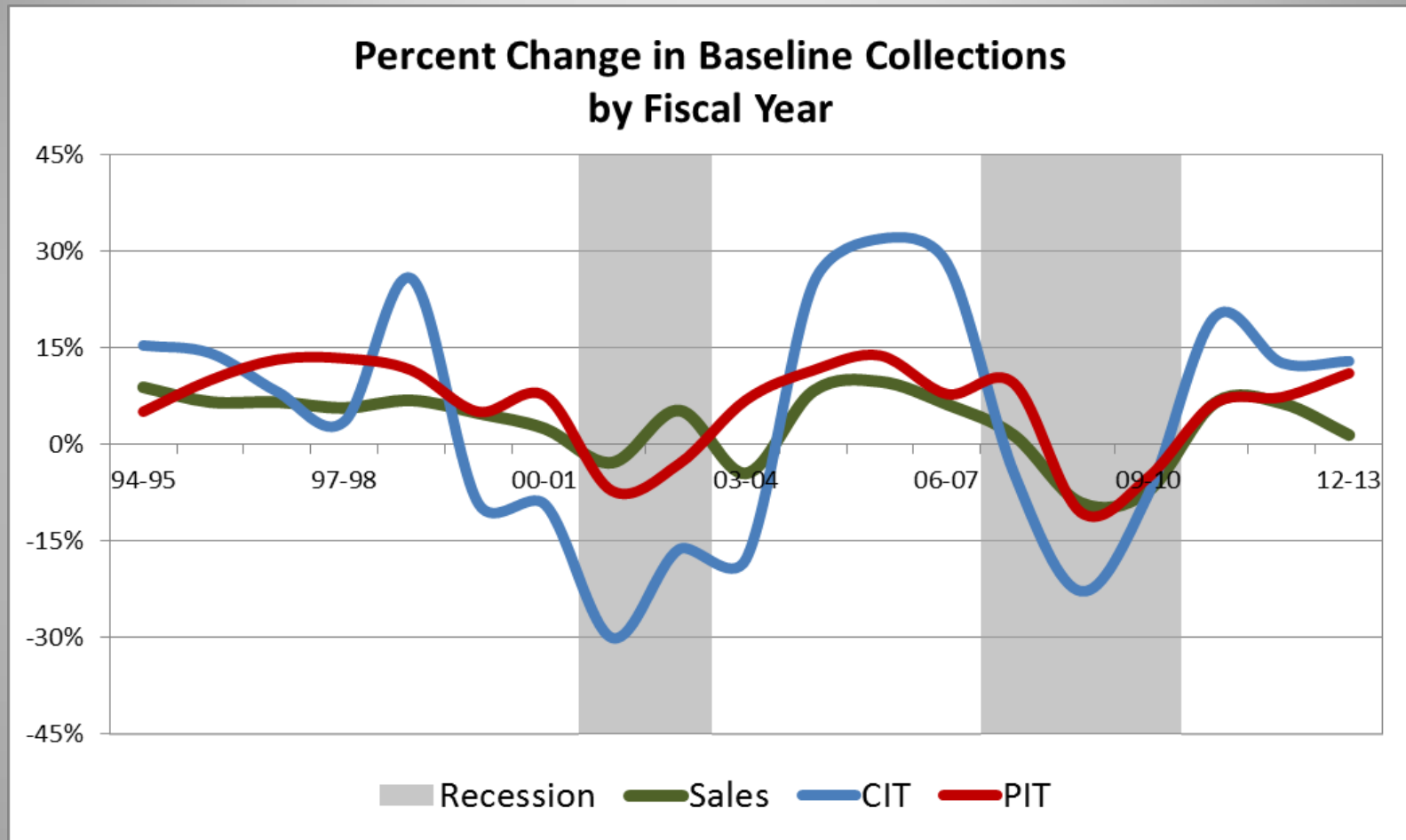


# Comparing Changes in Sales Tax & Income Tax Collections 1994-2013



From General Assembly Fiscal Staff; Baseline revenue starts with collections in FY 1994-95, and removes any subsequent tax law changes affecting tax rates and tax bases.

# Comparing Changes in Collections of CIT, PIT & Sales Tax 1994-2013



From General Assembly Fiscal Staff; Baseline revenue starts with collections in FY 1994-95, and removes any subsequent tax law changes affecting tax rates and tax bases.

# State Revenue Volatility Has Resulted in a History of Budget Shortfalls

- **FY 1990-1991**
  - 8.1% shortfall
  - \$600 million expenditure cuts
  - \$600 million tax increase
- **FY 2001-02, 2005-06**
  - 10.8% shortfall
  - Temporary sales tax increase
  - Temporary income tax increase
- **FY 2008-09**
  - 15.2% shortfall
  - Increase 'sin' taxes
  - Temporary sales & income tax increase

# State Revenue Volatility Resulting in a History of Budget Shortfalls

- **FY 2010-11 to FY 2012-13**

- 1 to 3% surpluses
- Ended 1% Temporary Sales Tax Rate Increase
- Eliminated Temporary Income Tax Rate Increase

- **FY 2013-14**

- **2.2%** shortfall
- Federal Fiscal Cliff
- Timing of Tax Law Changes

## **Next Recession?**

**NC's tax structure has not changed as much as needed to reflect changes in our economy**

**History suggests another recession & shortfall**

**Could next serious shortfall be worse?**

# **Senate Finance Committee Meeting in 2013---4 Independent Economists Agree:**

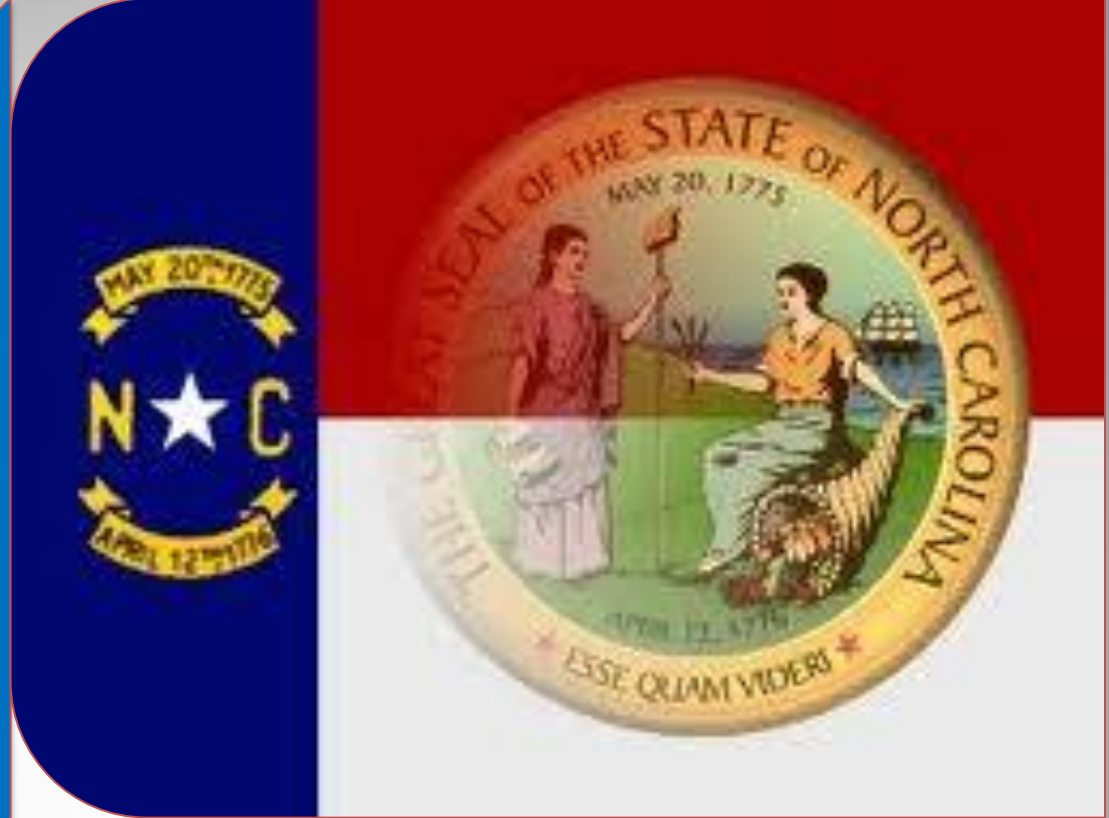
- North Carolina's current tax code is **outdated** and **unsuitable** for the 21<sup>st</sup> Century Economy
- Economic incentives have not produced jobs
- Reduce personal/corporate income tax rates
- **Broaden sales tax base to more retail goods & services**
- Eliminate sales taxes on B2B transactions
- Tax reform is only one factor in creating a **BETTER** North Carolina economy



# Why More Tax Reform Is Needed

- Pitiful job growth & increasing poverty in NC despite billions spent on economic incentives
- Underperforming per capita income growth
- Major shift in how NC economy functions
- Shrinking sales tax base
- Continued & increasing reliance on volatile income taxes for a majority of state revenues
- 1930's tax statutes do not work well for a 21<sup>st</sup> Century Economy

?QUESTIONS?



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Thanks to Brent Lane, Barry Boardman ,Ted Abernathy & Michael Mazerov for providing graphs and statistics for this presentation